

Calendar No. 445

86TH CONGRESS }
1st Session }

SENATE

{

REPORT
No. 450

AMENDING TITLE XI OF THE MERCHANT MARINE ACT, 1936, TO PROVIDE FOR THE DEPOSIT OF FUNDS IN ESCROW WITH THE SECRETARY OF COMMERCE, TO PROVIDE FOR THE PAYMENT OF INSURANCE, IN PART, ON THE BASIS OF SUCH DEPOSITS

JUNE 29, 1959.—Ordered to be printed

Mr. MAGNUSON, from the Committee on Interstate and Foreign Commerce, submitted the following

REPORT

[To accompany S. 2148]

The Committee on Interstate and Foreign Commerce, to whom was referred the bill (S. 2148) to amend title XI of the Merchant Marine Act, 1936, as amended, to provide for the deposit of funds in escrow with the Secretary of Commerce, to provide for the payment of insurance, in part, on the basis of such deposits, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

PURPOSE OF THE BILL

Title XI of the Merchant Marine Act, 1936, as amended, authorizes the Secretary of Commerce to insure ship construction loans and ship mortgages given to finance construction. Save for certain exceptional cases where the mortgage may equal 87½ percent of the actual cost of the vessel, an insured loan or mortgage may not exceed 75 percent of such actual cost. If the loan or mortgage does not exceed this amount, and meets other eligibility requirements of the act, the Secretary may insure 100 percent of the principal and interest of such loan or mortgage.

During the construction period and until all costs are paid by the owner, however, this 100-percent insurance is not 100 percent payable. While the "actual cost," 75 percent (or 87½ percent) of which measures the maximum amount of the insured loan or mortgage, is defined to include both amounts paid and amounts which the owner is obligated to pay for construction, the proviso of section 1101(f) limits insurance payable by the Secretary to 75 percent of amounts actually paid by the owner on construction costs. Thus, the Secretary will never

pay out insurance in excess of 75 percent of the value then in the vessel as reflected in construction costs already paid.

The bill would amend the existing law so as to allow the Secretary to pay as insurance the full amount of principal and interest on an insured loan or mortgage in any case where the owner has deposited with the Secretary in an escrow fund an amount equal to the difference between the principal of the loan or mortgage and 75 percent (or 87½ percent) of construction costs already paid, plus interest on that amount for the escrow period.

NEED FOR THE LEGISLATION

The present limitation on insurance payable has created no problem where the owner obtains his construction funds through private placements. There, the lender can advance the funds only as they are needed to pay construction costs, and under such an arrangement the insurance payable at any given time corresponds with the amount then advanced.

Experience indicates, however, that public bond issue financing offers substantially lower interest rates than do private placements. The present limitation on insurance payable does create a serious obstacle to resort to public issue financing because it is not feasible to float a public issue in installments to correspond with progress payments to the shipyard. Instead, the entire issue must usually be sold before all costs are paid. In such circumstances, the insurance payable would not under present law cover the entire bond issue.

The consequence of the bond issue not being fully secured by insurance payable is to increase the cost of the borrowing to the owner which, to the extent reflected in an increased interest rate, also increases the Government's contingent liability as insurer. This is so for a variety of reasons. The bond issue cannot qualify for the exemption from registration provided in section 3(a)(2) of the Securities Act (15 U.S.C. 77(c)(a)(z)) for Government-guaranteed securities. It cannot qualify as an obligation of the United States which national banks (15 U.S.C. 24), Federal Reserve System member banks (12 U.S.C. 335) and other regulated investors can purchase. And it is not, of course, as attractive to private investors.

EFFECT OF THE BILL

The bill would permit the owner to float a public bond issue fully secured by insurance payable without in any way increasing the Government's insurance risk. Insurance can be made fully payable at the time the issue is sold only if there is deposited in escrow with the Secretary of Commerce the proceeds of the issue in excess of 75 percent (or 87½ percent) of amounts already paid against construction cost, together with other funds sufficient to pay interest on such deposited proceeds for the escrow period.

The funds so deposited in escrow are to be disbursed only (1) to pay construction costs, (2) to pay the insurance in event of default, or (3) to redeem bonds. Although the bond issue is fully secured, principal and interest, by insurance payable, the effect of this escrow fund is to confine the Government's insurance risk, as it is under existing law, to the payment of insurance against 75 percent (or 87½ percent) of construction costs actually paid.

In order to avoid undue loss to the owner through having his interest-bearing borrowed funds deposited in the escrow account, the Secretary is authorized to invest them in marketable interest-bearing obligations of the United States with such maturities as are consistent with the purposes of the escrow arrangement. Income realized upon such investments is to be paid to the owner.

Other provisions of the bill authorize the Secretary to make a charge for services in connection with the escrow fund in lieu of an insurance premium charge for so much of the insurance as is free of all risk by reason of amounts on deposit in the escrow fund.

SUMMARY OF DEPARTMENTAL RECOMMENDATIONS

The Department of Commerce recommended enactment of the bill with two proposed amendments which were adopted by your committee. One would restrict the insurance charge to the amount of insurance not protected by the escrow deposit.

The other proposed amendment would confine the Secretary's authority to invest the escrow fund to marketable interest-bearing obligations of the United States, eliminating those of Federal agencies and those fully guaranteed and/or insured by the United States.

This second amendment was adopted by your committee because the evidence received at a hearing on this legislation indicated that the securities of Federal agencies and securities insured by the United States would not at this time yield substantially greater income than direct obligations of the United States. However, at some future time it might be advisable to amend this provision in order that the Secretary of Commerce be allowed to invest in securities of Federal agencies or securities fully insured and/or guaranteed by the United States.

The Comptroller General suggested several changes of a clarifying nature rather than substantive amendments. Your committee carefully examined each of the suggestions, adopting those that would facilitate the administration of the bill herein reported.

AGENCY COMMENTS

Letter from General Accounting Office is attached.

Department of Justice did not care to comment.

COMPTROLLER GENERAL OF THE UNITED STATES,

Washington, June 17, 1959.

B-115403.

HON. WARREN G. MAGNUSON,

*Chairman, Committee on Interstate and Foreign Commerce,
U.S. Senate.*

DEAR MR. CHAIRMAN: Your letter dated June 12, 1959, acknowledged June 15, requested our comments on S. 2148, 86th Congress.

S. 2148 would amend title XI of the Merchant Marine Act, 1936, as amended, to permit the Secretary of Commerce to accept, and act as escrow agent in connection with, moneys borrowed by vessel operators to facilitate the financing of construction, reconstruction or reconditioning of vessels. Additionally, the bill would direct the Secretary to disburse principal and interest to shipbuilders and lenders and, in case of default by borrowers, to pay loan or mortgage insurance in

amounts based upon sums paid by or for the account of the vessel operator plus the amounts representing principal and interest in the escrow account at time of default.

We understand that the request for this legislation arises as a result of our decision of April 27, 1959, B-135884, to the Maritime Administrator, in which we advised that there was no authority under existing law for the Secretary of Commerce, acting through the Maritime Administration, to assume the additional duties and responsibilities of an escrow agent or trustee of funds accruing from the public sale of bonds issued by vessel operators to finance the construction of new vessels. A copy of our decision in that case is enclosed.

Whether legislation should now be enacted to specifically authorize the assumption of such additional duties and responsibilities would appear to involve consideration of the following primary questions of policy:

1. The insurance of loans and mortgages financed by the sale of bonds to the public, with a private trust company acting as trustee of the proceeds of such sale, is presently authorized under title XI of the act. Should the Government now enter this field of private business activity?

2. The bill contemplates savings to vessel operators resulting principally from interest rates lower than the rates obtainable if bonds are issued with a private banking institution acting as escrow agent. If this is true, would the amount of such savings justify the assumption of fiduciary duties and responsibilities by the United States?

3. One anticipated result of the proposed escrow arrangement is to increase the marketability of bonds, which are issued subject to such arrangement, by making such bonds fully insured and/or guaranteed by the Government. As such, the bonds apparently would not be subject to the restrictions imposed by 12 U.S.C. 24 and 12 U.S.C. 335, and such bonds would be available for unrestricted investment by national banks and by member banks of the Federal Reserve System. Should the number and types of this class of investments be increased by enactment of the legislation now proposed?

4. Since no insurance obligation on the part of the United States is contemplated under the bill until such time as the proceeds from sale of bonds are deposited in escrow with the Secretary of Commerce, can such bonds, uninsured at the time of sale, properly be classified and sold as Government-insured bonds?

In view of the above questions of policy, we make no recommendation with respect to enactment of S. 2148. However, in the event these questions are decided in the affirmative, we would like to offer the following comments for your additional consideration.

Lines 7 and 8, page 1, of the bill would amend the present restriction on the amount of insurance payable at default in section 1101(f) by adding "in respect of the unpaid balance of the principal of a mortgage or loan." We have no information relative to the purpose to be served by the amendment, and, in view of the specific provisions in the remaining portions of the bill for payment of insurance in excess of the section 1101(f) restriction where an escrow fund is held by the Secretary of Commerce, we question the necessity for this amendment and suggest that it be deleted.

As indicated above, we understand the request for this legislation is based upon, and limited to, the need for depositing the proceeds

of bonds sold to the public in escrow with the Secretary of Commerce. However, the provisions of section 1111(a), as proposed by section 2 of the bill, are not so limited and, consequently, may be interpreted to authorize the establishment of escrow accounts under all types of borrowings. In view thereof, you committee may wish to add the phrase "which are financed by sale of bonds to the general public," immediately following the word "mortgages," in line 13, page 2, of the bill.

We assume that the word "thereon" in line 21, page 2, of the bill refers to the full amount of the mortgage or loan, even though a portion of such amount may be retained by the borrower under proposed section 1111(a) instead of being deposited into the escrow fund. If so, we suggest that the phrase "on the full amount of the loan or mortgage" be substituted for the word "thereon."

Section 1111(b), as proposed by the bill would require the Secretary of Commerce to pay interest and principal as specified in the escrow agreement. Assuming bonds were issued and sold to the public under a trust indenture it would appear that the Secretary could be required by the terms of the escrow agreement to make interest payments either directly to the individual bondholders or to the trustee named in the trust indenture. Payment of interest to the individual bondholders under several hundred potential escrow accounts could result in a considerable administrative burden. Additionally, under the provisions of section 1101(d) it would appear that no direct obligation on the part of the United States to bondholders was intended under title XI. In the interest of clarification it is therefore suggested that section 1111(b) be amended to either specifically direct payment of interest to the trustee or to the individual bondholders.

The phrase "subject to the application of mortgage provisions contemplated by section 1104(a)(10) of this Act" in lines 9 through 11, page 3, apparently refers to that portion of section 1104(a)(10) which authorizes the insertion of a provision in mortgages on completed passenger vessels under which the sole recourse by the United States against the mortgagor in the event of default shall be limited to repossession of the vessel. The effect of the above-quoted provision would be to extend the sole recourse provision of section 1104 (a)(10) to insured loans during the construction period of a passenger vessel. In the event of default during the construction of a passenger vessel, such sole recourse provision would therefore operate to preclude "any amount becoming due to the Secretary of Commerce from the borrower or mortgagor with respect to the insured loan or mortgage" under subsection 1111(b)(i). Consequently, under subsection 1111 (b)(ii) all amounts remaining in the escrow account at time of default would be payable to the borrower or mortgagor and would not be available to discharge the Government's obligations under the insurance contract. We fail to see any valid reason why amounts remaining in the escrow account at time of default should be returned to the mortgagor, rather than set off against payment of the insurance obligation. We therefore suggest that the phrase quoted above be deleted from section 1111(b).

With respect to section 1111(d) it is our opinion that moneys in escrow should be deposited in the Treasury and should be invested in the same manner as the Federal ship mortgage insurance fund as prescribed in section 1102. We therefore suggest that section 1111(d) be amended to read as follows:

"(d) Escrow funds received by the Secretary of Commerce under this section shall be deposited in the Treasury and may be invested in bonds or other obligations of, or guaranteed as to principal and interest by, the United States."

We believe that the authority granted under section 1111(f) is broader than necessary or intended and could well result in the Government incurring liabilities in excess of those intended by section 1111. We therefore suggest that the phrase "may consider necessary to fully protect the interests of the United States" be substituted for the word "prescribes" in line 18, page 4.

While we are in agreement with the proposal in section 4 of the bill authorizing the Secretary of Commerce to charge and collect for services in connection with the escrow fund, your Committee may wish to consider the desirability of raising the present ceiling of one-half of 1 percent for service charges which is contained in section 1104(e) to correspond with and compensate for the additional services contemplated by S. 2148.

Sincerely yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in *italic*, and existing law in which no change is proposed is shown in roman):

TITLE XI—FEDERAL SHIP MORTGAGE INSURANCE

SEC. 1101

- (a) * * *
- (b) * * *
- (c) * * *
- (d) * * *
- (e) * * *

[(f) The term "actual cost" of a vessel as of any specified date means the aggregate as determined by the Secretary of Commerce of (i) all amounts paid by or for the account of the mortgagor or borrower on or before that date, and (ii) all amounts which the mortgagor or borrower is then obligated to pay from time to time thereafter, for the construction, reconstruction, reconditioning (including designing, inspecting, outfitting, and equipping) of such vessel: *Provided*, That in no event shall the Secretary of Commerce pay as insurance under this title an amount in excess of 75 per centum, or 87½ per centum, as the case may be, of the amount paid by or for the account of the mortgagor or borrower for the construction, reconstruction, or reconditioning (including designing, inspecting, outfitting, and equipping) of such vessel.]

(f) *That in no event shall the Secretary of Commerce pay as insurance under this title in respect of the unpaid balance of the principal of a mortgage or loan an amount in excess of 75 per centum, or 87½ per centum, as the case may be, of the amount paid by or for the account of the mortgagor*

or borrower for the construction, reconstruction, or reconditioning (including designing, inspection, outfitting, and equipping) of such vessel, except that if the mortgagor or borrower creates an escrow fund as authorized by section 1111 of this Act, the amount that shall be paid as insurance is the interest on and the unpaid balance of the principal of such loan or mortgage.

SEC. 1102 * * *

SEC. 1103 * * *

SEC. 1104

(a) * * *

(b) * * *

(c) * * *

(d) The Secretary of Commerce is authorized to fix a premium charge for the insurance of mortgages and loans under this title. In the case of any mortgage insured under section 1103(a) (46 U.S.C. 1273(a)), such charge shall not be less than one-half of 1 per centum per annum nor more than 1 per centum per annum of the average principal amount of the mortgage outstanding, *excluding the average amount (except interest) on deposit in an escrow fund created under section 1111 of this Act.* In the case of loans insured under section 1103(b) (46 U.S.C. 1273 (b)), such charge shall not be less than one-quarter of 1 per centum per annum nor more than one-half of 1 per centum per annum of the average principal amount of the loan outstanding, *excluding the average amount (except interest) on deposit in an escrow fund created under section 1111 of this Act.* Premium payments shall be made when moneys are first advanced under the mortgage or loan agreement and on each anniversary date thereafter. All such premium charges shall be computed and shall be payable to the Secretary of Commerce under such regulations as the Secretary of Commerce may prescribe.

(e) The Secretary of Commerce shall charge and collect such amounts as he may deem reasonable for the investigation of applications for insurance, for the appraisal of properties offered for insurance, for the issuance of commitments, *for services in connection with the escrow fund authorized by section 1111* and for the inspection of such properties during construction, reconstruction, or reconditioning: Provides, That such charges shall not aggregate more than one-half of 1 per centum of the original principal amount of the mortgage or loan to be insured. Unless otherwise agreed, the charge for any such services shall be paid by the mortgagor or the borrower.

(f) * * *

SEC. 1105 * * *

SEC. 1106 * * *

SEC. 1107 * * *

SEC. 1108 * * *

SEC. 1109 * * *

SEC. 1110 * * *

1111. (a) *CREATION OF THE ESCROW FUND.* In connection with the insurance of loans and mortgages, which are financed by sale of bonds to the general public the Secretary of Commerce is authorized to accept a deposit in escrow in an amount which at the time of such deposit is equal to (i) the excess of the principal of such loan or mortgage over 75 per centum, or 87½ per centum, as the case may be, of the amount paid by or for the account of the mortgagor or borrower for the construc-

tion, reconstruction, or reconditioning (including designing, inspection, outfitting, and equipping) of the vessel, (ii) with interest thereon for the period of the escrow agreement.

(b) *DISBURSEMENT PRIOR TO TERMINATION OF THE ESCROW AGREEMENT.*—The Secretary of Commerce shall, as specified in the escrow agreement, disburse the escrow fund to pay amounts the mortgagor or borrower is obligated to pay as interest on such loan or mortgage or for the construction, reconstruction, or reconditioning (including designing, inspecting, outfitting and equipping) of the vessel, except that if insurance becomes payable under the insurance contract prior to the termination of the escrow agreement, all amounts in the escrow fund at the time such insurance becomes payable (including realized income which has not yet been paid to the borrower or mortgagor) shall, subject in the case of insurance on a mortgage to the application of mortgage provisions contemplated by section 1104(a)(10) of this Act, be paid into the Federal Ship Mortgage Insurance Fund and (i) be credited against any amounts due or to become due to the Secretary of Commerce from the borrower or mortgagor with respect to the insured loan or mortgage and (ii) to the extent not so required, be paid to the borrower or mortgagor.

(c) *DISBURSEMENT UPON TERMINATION OF THE ESCROW AGREEMENT.*—If insurance has not become payable under the insurance contract prior to the termination of the escrow agreement, any balance of the escrow fund at the time of such termination shall be disbursed by the Secretary of Commerce to prepay the excess of the principal of the loan or mortgage over 75 per centum, or 87½ per centum, as the case may be, of the actual cost of the vessel to the extent paid, and to pay interest on such prepaid amount of principal, and the remainder of such balance of the escrow fund shall be paid to the borrower or mortgagor.

(d) *INVESTMENT OF THE ESCROW FUND.*—The Secretary of Commerce may invest and reinvest all or any part of the escrow fund in obligations of the United States with such maturities that such fund will be available as required for purposes of the escrow agreement.

(e) *INCOME ON THE ESCROW FUND.*—Any income realized on the escrow fund shall, upon receipt by the Secretary of Commerce, be paid to the borrower or mortgagor.

(f) *OTHER TERMS.*—The escrow agreement shall contain such other terms as the Secretary of Commerce may consider necessary to fully protect the interests of the United States.

